STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

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Summary:

Washington; Appropriations; General Obligation

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Credit Profile		
US$402.035 mil motor veh fuel tax GO rfdg bnds ser R-2015B due 07/01/2026		
Long Term Rating	AA+/Stable	New
US$392.575 mil var purp GO rfdg bnds ser R-2015A due 07/01/2026		
Long Term Rating	AA+/Stable	New
US$114.268 mil var purp GO bnds ser 2015A-2 due 08/01/2039		
Long Term Rating	AA+/Stable	New
US$114.268 mil var purp GO bnds ser 2015A-1 due 08/01/2039		
Long Term Rating	AA+/Stable	New
US$85.98 mil GO bnds ser 2015T due 07/01/2026		
Long Term Rating	AA+/Stable	New
Washington GO		
Long Term Rating	AA+/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'AA+' long-term rating to Washington's:

- $228.5 million various purpose general obligation (GO) bonds, series 2015A-1 (competitive sale) and series 2015A-2 (negotiated sale);
- $85.98 million GO bonds (taxable) series 2015T;
- $392.6 million various purpose GO refunding bonds, series R-2015A; and
- $402 million motor vehicle fuel tax (MVFT) GO refunding bonds, series R-2015B.

At the same time, we affirmed our 'AA+' long-term rating and underlying rating (SPUR) on the state's existing GO and MVFT GO debt. The outlook on all long-term ratings is stable. We also affirmed our 'AA' rating on the state's appropriation-backed debt.

The ratings reflect our view of the state's:

- Relatively well-educated workforce and good income indicators;
- Sales tax-based revenue structure that exhibits sensitivity to economic cycles but to a lesser degree than those of states that rely primarily on personal and corporate income taxes;
- Good internal access to sources of liquidity;
- Strong financial policies and practices, including new statutory provisions requiring that the state's biennial budget and projected subsequent two fiscal years' spending plans be balanced; and
- Moderately high per capita debt burden but well-funded pension plans.

The state's full faith, credit, and taxing powers secure the state's GO bonds. The state's MVFT GO bonds are first payable from state excise taxes on motor vehicle and special fuels. According to the state Treasurer's office, proceeds from the GO bonds will be used to provide funds to pay and reimburse state expenditures for various capital projects and state programs. The refunding GO and refunding MVFT GO bonds are being issued to refinance some of the state's existing debt.

The state will have a total of $18.96 billion of GO bonds outstanding after the current offering. Of this, $7.45 billion of the state's GO debt is payable first from state excise taxes on motor vehicle and special fuels or toll revenue. The state also has $1.03 billion of certificates of participation and other appropriation-backed debt outstanding. Of this, $84.5 million is GO debt of various local agencies within the state and is a contingent obligation of the state government in the event of nonpayment by a local government agency.

After having had to solve a projected $2.5 billion budget shortfall coming into the current budget biennium, the governor and legislature agreed on a "hold steady" fiscal 2015 supplemental budget. As such, the fiscal 2015 supplemental budget added about $66 million in net new spending (for a total of $33.7 billion for the two years) mostly to accommodate caseload growth. The state's Economic and Revenue Forecast Council (EFRC) raised its revenue forecast for the biennium in September by $345 million, $11 million in November, and most recently, another $60 million in February. The higher than originally expected revenue growth brings its projected ending balance to $296 million compared with the $53 million expected at the time the budget was enacted. The budget also included a $309 million transfer to the state's budget stabilization account. Including about $3 million in expected interest earnings and the $269 million beginning stabilization account balance, the state's total ending and reserve balances at the end of the biennium should sum to about $879 million, or almost $250 million above what it expected upon budget enactment. At the end of the current fiscal year on June 30, the state anticipates a combined ending and stabilization fund balance of $686 million, or 4.3% of state general fund expenditures, which we view as good.

There is potential for increasing fiscal pressure stemming from a court ruling mandating that the state significantly increase funding for its kindergarten through grade 12 education system. In 2012, the State Supreme Court ruled (McCleary vs. State of Washington) that state funding for education falls short of what the state constitution calls for. The court did not specify how much additional funding was necessary, but there was broad consensus on the need for about $1 billion in additional education spending in the 2013-2015 biennium, which the budget included. On a supplemental basis, the legislature added $58 million in funding to the education budget for fiscal 2015. But according to a report from the legislature's joint select committee, by fiscal 2019, the state would need to spend another $1.9 billion annually on education to bring the state into compliance with the court's ruling. As it stands, approximately 46% of the state-funded portion of general fund expenditures goes toward public education.

The legislature has taken a more structural approach to crafting fiscal policy, in our view, thanks to a 2012 statute requiring the state to enact a budget that it projects will remain balanced through four fiscal years. Although for technical reasons additional education-related expenses resulting from the McCleary decision were excluded from general fund expenditure estimates for the current biennium, they will be included in future forecasts. Notwithstanding this, we believe the statute has favorable implications for the state's credit quality by encouraging a greater use of ongoing solutions to projected budget shortfalls, when they arise.

In general, Washington's approach to financial management is strong, in our view, as reflected in our Financial Management Assessment and budget management scores. Well-established economic and revenue forecasting and increasingly refined debt management practices and oversight served the state's credit quality well during the recession and its aftermath. Forward-looking state policies facilitate budget practices we view as prudent, including minimal reliance on payment deferrals or other one-time responses to anticipated budget gaps.

In 2013, real state GDP expanded at an estimated 2.4% rate, well ahead of the national growth rate of 1.9%. However, the pace of expansion in Washington remains gradual and could slip to somewhat below the nation in 2014. In our view, the slowdown will likely be a temporary soft patch brought about by a harsh winter that undercut demand for the state's manufacturing production, as well as workforce reductions at Boeing. Therefore, whereas we forecast real GDP to grow 2.5% nationally in 2014, our expectations for Washington, based on IHS Global Insight modeling, is 2.1%. Nevertheless, from 2000 through 2012, the state's real GDP compound annual growth rate of 2.22% has outpaced the national rate of 1.53%. Furthermore, we anticipate the state's economy will accelerate to a growth rate approximately equal to the nation in 2015. Looking ahead, according to the IHS Global Insight model, we estimate that the state's economy should grow by 2.5% and 3.1% in 2014 and 2015. Using the same source of data, we estimate that state personal income increased 3.2% in 2013 and is poised to accelerate somewhat at 4.1% and 5.4% in 2014 and 2015, respectively. The ERFC forecast is similar and estimates that state personal income grew at 3.1% in 2013 and will increase to slightly above 4.7% in 2014 and 5.3% 2015.

Overall, employment trends, which had fallen behind the U.S. in November, picked up the pace again as of April. In the 12 months through April, payroll jobs in Washington increased by 2.16% compared with the nation, which saw a jobs growth rate of 1.74%. At this point, the state has recovered all of the jobs it lost during the Great Recession. From March 2008 through February 2010, the state lost 184,200 payroll jobs but since then has added back 215,200 jobs. Employment gains have been strongest in the state's construction, natural resources, and mining sector (up 4.2% year over year); trade, transportation, and utilities (up 3.1% year over year); leisure and hospitality (3.5%); and professional and business services (2.8%) sectors. At the end of April, Washington's unemployment rate, at 6.1%, was lower than the nation's 6.3%.

The Boeing Co. remains the state's largest employer with 85,000 employees in Washington, and through its demand for services and supplies, has spawned an aerospace industry throughout the state. Overall there are about 1,350 aerospace firms in the state employing more than 131,000 people. Marking a bit of a setback, however, was Boeing's announcement early in 2014 that it was eliminating about 4,300 engineering jobs from the state.

Through the first quarter of 2014, housing starts came in slightly below the state's forecast with multifamily starts making up for more substantial underperformance relative to the forecast in single family starts. With a seasonally adjusted annual rate of 31,200 new housing permits issued during the first quarter, the state is slightly behind the 31,400 that had been forecast for the period. However, this included a weaker-than-expected January, suggesting there could be some upside to the state's housing market as the year progresses. In 2013, housing permits increased 8.8% over the number issued in 2012. In addition, , according to the S&P/Case-Shiller Home Price Index, home prices in the Seattle metro area increased 12% in the 12 months through March 2014, similar to the 12.4% increase for the 20-city composite index. Prices are also 26% above the trough they reached in November 2011.

For May 2014, the state treasury and treasurer's trust fund's month-end cash balance was $4.77 billion, above the $4.2 billion balance at the same time in 2013. Investments are conservative, in our view, with an average of 66.7% of funds invested in U.S. Treasurys and agencies in April 2014. Repurchase agreements, which are subject to a maximum term of 180 days, represented just 1.2% of investments. In addition to the state's investment guidelines, state policies require that collateral in repurchase agreements for U.S. Treasury, agency, and money market instruments be priced at 102% of market value. Mortgage-backed repurchase agreements of more than seven days are subject to a higher, 105% requirement.

As of the end of fiscal 2013, the state's direct tax-supported debt burden ($19.2 billion in GO and appropriation-backed bonds outstanding) was moderately high, in our opinion, at $2,784 per capita (based on the U.S. Census 2013 state population of 6.9 million), 5.9% of total personal income (2013), and 4.7% of state gross domestic product (2013).

Gross GO and lease appropriation-backed debt service is moderate, at 5.56% of general governmentwide (all funds) spending in fiscal year 2013 (audited). Portions of the state's debt are funded from self-supporting or reimbursable sources, however. Considering just the general fund, adjusted for these offsetting revenues, we estimate that debt service was 6.0%, moderate in our view. We anticipate that continuing transportation needs, including two major urban highway projects, will likely translate into continuing GO issuance in the next two to three years. The state currently projects that it may issue approximately $861 million in new GO and MVFT GO bonds in January 2015. The state also estimates that it may issue around $85 million in certificates of participation in 2014.

Based on the analytic factors we evaluate for states, on a scale of 1 (strongest) to 4, we have assigned Washington a composite score of '1.8'.

Outlook

The stable outlook reflects our view that the state's liquidity, financial trends, and strengthening economy point to an improving financial position. Coupled with the state's strong financial management policies and institutions, we see the state's credit rating as stable through the outlook period. Although the pace of economic and job recovery has leveled off a bit recently, we believe the broader economic expansion is embedded well enough to promote the state's ongoing recovery. In our view, the state's credit rating could come under negative pressure if -- in a more negatively trending economy – state lawmakers had difficulty reaching a timely resolution of any resultant budget deficit. (The fiscal 2013-2015 budget development process was more acrimonious than usual for the state.)

The state's automatic budget-stabilization fund deposits, which it continued to make despite the difficult budget process, are likely to serve its credit quality well when the economy -- and revenues -- take a negative turn. At present, the state is in a reserve rebuilding phase, which we view as important to the state's credit quality going forward. The state's tendency to deplete reserves during economic downturns limits the state's rating from rising.

Downside credit risk could originate from an economic downturn or from decisions made during the development of the 2015-2017 biennial budget, which will necessitate a solution to the court-ordered increase in education funding.

Related Criteria And Research

Related Criteria

- USPF Criteria: State Ratings Methodology, Jan. 3, 2011
- USPF Criteria: Financial Management Assessment, June 27, 2006
- USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

Related Research

U.S. State And Local Government Credit Conditions Forecast, April 7, 2014

Ratings Detail (As Of June 11, 2014)		
Washington certs of part (Washington St Dept of Gen Admin Tacoma Co-Location Proj) dtd 12/01/1996		
Long Term Rating	AA/Stable	Affirmed
Washington motor veh fuel tax GO rfdg bnds		
Long Term Rating	AA+/Stable	Affirmed
Washington motor veh fuel tax GO rfdg bnds ser R-2013B		
Long Term Rating	AA+/Stable	Affirmed
Washington mtr veh fuel tax go bnds ser 2004C dtd 08/06/2003 due 06/01/2009-2030		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington mtr veh fuel tax GO bnds ser 2013B-1&2 due 08/01/2042		
Long Term Rating	AA+/Stable	Affirmed
Washington mtr veh fuel tax GO bnds ser 2014E due 02/01/2039		
Long Term Rating	AA+/Stable	Affirmed
Washington mtr veh fuel tax GO rfdg bnds		
Long Term Rating	AA+/Stable	Affirmed
Washington various purp gen oblig bnds		
Long Term Rating	AA+/Stable	Affirmed
Washington various purp GO rfdg bnds ser R-2014A due 07/01/2020		
Long Term Rating	AA+/Stable	Affirmed
Washington var purp GO bnds ser 2014D due 02/01/2039		
Long Term Rating	AA+/Stable	Affirmed
Washington var purp GO rfdg bnds ser R-2013C		
Long Term Rating	AA+/Stable	Affirmed
Washington GO		
Long Term Rating	AA+/Stable	Affirmed
Washington GO bnds		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO bnds ser 2013T due 08/01/2018		
Long Term Rating	AA+/Stable	Affirmed
Washington GO Mtr Veh Fuel Tx		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed

Ratings Detail (As Of June 11, 2014) (cont.)		
Washington GO & mtr veh fuel tax (MBIA/National)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO (wrap of insured) (AMBAC) (ASSURED GTY - SEC MKT)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO (wrap of insured) (FGIC & AGM) (SEC MKT)		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Washington GO (Motor Vehicle Fuel Tax)		
Long Term Rating	AA+/Stable	Affirmed
Washington certs of part rfdg (Dept of Ecology St Office Bldg Proj) ser RE-2003-B		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Washington GO		
Unenhanced Rating	AA+(SPUR)/Stable	Affirmed
Aberdeen, Washington		
Washington		
Aberdeen (Washington) spl rfdg rev bnds (Stafford Creek Corrections Ctr) ser 2009		
Long Term Rating	AA/Stable	Affirmed
FYI Properties, Washington		
Washington		
FYI Properties (Washington) Lease rev bnds (State Of Washington Dis Proj) ser 2009		
Long Term Rating	AA/Stable	Affirmed

Many issues are enhanced by bond insurance.

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